# PRIIPS - What Every Intermediary Needs to Know

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PRIIPs (Packaged Retail and Insurance-based Investment Products) legislation, Regulation (EU) No 1286/2014, introduces a new pre-sale disclosure requirement which must be provided to retail investors across the EU in good time before they make their investment decision. Packaged investment products that are within the scope of the regulation include life insurance investment products, investment funds, structured deposits and derivative instruments. Pensions are currently suggested to be out of scope. The regulation comes into effect from January 2018. Similar to the UCITS KIID, the PRIIPs KID (Key Information Document) aims to explain risk, reward and costs to the retail investor in a concise document.

Anyone advising on or selling a packaged investment product will be required by the legislation to give the retail investor a copy of the KID in good time before they are bound by any contract or offer. It is therefore imperative for intermediaries to familiarise themselves with their responsibilities under the legislation, the content of the Key Information Document and how it might impact interactions with their clients.

## Why is PRIIPs being introduced?

The main purpose of the legislation is for the enhanced protection of the retail investor. This was to be achieved through the provision of a Key Information Document that would be easy to read and understand, prepared using a common template enabling easy comparison of the investment products offered by different sectors across the EU.

## What is the KID?

The PRIIPs KID is a document which must be produced by product manufacturers and provided to retail investors by the person advising on or selling the product before the consumer makes their investment decision. It can be no more than three A4 pages long and will be produced using a generic premium of €10,000 for lump sum investments and €1,000 per annum for regular contributions. Product manufacturers must make the KID for each of their products available on their website and update the information in the KID at least once a year. The KID contains three main sections covering risk, reward and costs:

**1) The Summary Risk Indicator (SRI)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|

**Lower risk** ← → **Higher risk**

This section aims to represent the risk of a product on a scale of 1 to 7. Similar to the ESMA risk scale, the volatility of the investment over the past five years is used to determine the risk level. Unlike ESMA however, the PRIIPs legislation has identified both market and credit risk as factors that need to be reflected in the Summary Risk Indicator, alongside liquidity risk. The formula for the calculation of the SRI is prescribed by legislation and product manufacturers cannot adjust the risk level in any way.

**Key Watch Out:**
Investments may have a different risk number on the PRIIPs scale than they have on the ESMA scale. Many will appear as a lower risk number on the PRIIPs risk scale because the volatility bands under PRIIPs are much broader. For example, an ESMA 3 has a volatility band of 2%-5%, whereas under the PRIIPs risk indicator a 3 has a volatility of 5%-12%. To be assigned a 7 in PRIIPs the volatility must be over 80%, whereas an ESMA 7 is a fund with volatility of over 25%. Investments that have different ESMA risk numbers may all have the same risk number under PRIIPs due to the broader volatility bands.

**2) The Performance Scenarios**

| Investment Scenarios | | 1 year | [3] years | [5] years (Reccomended holding period) |
|---|---|---|---|---|
| **Stress scenario** | **What you might get back after costs**<br>Average return each year | ❑<br>❑ | ❑<br>❑ | ❑<br>❑ |
| **Unfavourable scenario** | **What you might get back after costs**<br>Average return each year | ❑<br>❑ | ❑<br>❑ | ❑<br>❑ |
| **Moderate scenario** | **What you might get back after costs**<br>Average return each year | ❑<br>❑ | ❑<br>❑ | ❑<br>❑ |
| **Favourable scenario** | **What you might get back after costs**<br>Average return each year | ❑<br>❑ | ❑<br>❑ | ❑<br>❑ |

Not dissimilar to the range of returns that many providers are now producing, the PRIIPs performance scenarios aim to show the range of possible returns an investor might expect over different investment time horizons. The product provider must state the recommended holding period (even for open ended funds). The expected cash-in value after charges will be shown at this recommended holding period, and for two intermediate periods. Four different scenarios will be displayed.

The product manufacturer has little discretion in either the calculation or the presentation of these figures. The prescribed formulae will in many cases use the average performance and volatility of the investment over the past five years to determine the expected future possible returns.

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**Key Watch Out:**
Past performance is not a reliable guide to future performance! After five years of very good performance, the PRIIPs performance scenarios can show very good expected returns, and after a period of poor performance all the performance scenarios could potentially show negative expected returns. For example, in January 2007 the unfavourable scenario for an investment in a typical Irish property fund would have been +12% expected average annual return over the following five years, before charges. In January 2013 however, post financial crisis, the favourable scenario for the same investment would have been an expected average annual return of -12% - far from encouraging for any potential investor. With this heavy dependency on past performance, the PRIIPs performance scenarios have the potential to change dramatically as time passes. Intermediaries will be on the front line of explaining this to their clients both at the time of advice and potentially also post sale as investment returns are realised.

### 3) The Summary Cost Indicator (SCI)

| Investment [€10,000] Scenarios | If you cash in after [1] year | If you cash in after [recommend holding period/2] | If you cash in [at the end of the recommended holding period] |
|---|---|---|---|
| **Total costs** | - | - | - |
| Impact on return (RIY) per year | - % | - % | - % |

The KID cost disclosure will be called the Summary Cost Indicator (SCI). The costs are shown both in monetary terms and as a Reduction in Yield (RIY). Unlike the TER, the OCF seen in UCITS KIIDs and the RIY produced under life insurance disclosure requirements, the SCI aims to also capture transaction costs, including the impact of market movements between the timing of instruction and execution of the trade. Product manufacturers must follow the methodology prescribed in the legislation to calculate the SCI for their products, enabling an easier comparison of product charges for the consumer. The actual costs incurred on the investment over the recent past are used to determine the SCI. A further breakdown of the SCI is also provided in the KID, splitting it into items such as entry costs, exit costs, portfolio transaction costs and other ongoing and incidental costs. Adviser remuneration is not shown as a separate line item.

**Key Watch Out:**
A line will appear over the cost table stating "The person selling you or advising you about this product may charge you other costs. If so, this person will provide you with information about these costs, and show you the impact that all costs will have on your investment over time." You will need to be prepared to address this if it applies to you.

You will also need to be aware of the level of performance fees. If they have not been taken on the fund in the recent past due to the level of fund performance, they won't be represented in the costs shown in the KID.

## What intermediaries need to do before January 2018

- Familiarise yourself with the requirements of the legislation and how it will impact your business. Make sure you are ready and able to meet these requirements by the end of the year. From 1st January 2018 you will not be able to advise or sell the products that are within the scope of the legislation without providing your client with a KID.
- Talk to your preferred product providers about how they are going to make their KIDs available to you, how they will format the KID where there is a choice of investment options available, and any changes in their application processes. Ascertain which products they will be producing KIDs for and which of their products they believe are out of scope.
- Gain an understanding of the content of the KID. Examine how it can add value to your advice – product comparability across sectors being a potential benefit. Evaluate the challenges it will present, how you will provide it to your client, and how you will explain it if needed.

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